BACK TO RESULTS

NEW SEARCH

Economics focus: A working hypothesis

INDEX TERMS **Economics focuses|productivity, slow growth in America; Productivity|United States, slow growth, economics focus; United States|productivity's slow growth, economics focus;**

DATE **11-May-96**

WORDS **845**

Why is America's productivity growing more slowly than Europe's?

ASK any European economist what is today's biggest policy problem, and without hesitation he will say: unemployment. Ask an American economist the same question, and you will hear something about flagging productivity growth. America's flexible labour market may keep its dole queues short; but over the past two decades, its labour productivity has grown at a paltry rate. More than anything else, this lies behind the popular American complaint that living standards are stagnating.

Over the long run, nothing affects average workers' pay-packets more than labour productivity. The principle is simple: divide the total output of goods and services in different sectors by the number of manhours it took to produce them. Rising productivity is a sign that workers are churning out more per hour than in the past. This, in turn, implies that their total hourly compensation (wages plus other benefits, such as health care and pensions) should rise.

As chart 1 shows, America's non-farm labour productivity performance has been lacklustre for the past 25 years. (Farming is not counted because its output changes with the weather.) Average productivity grew by almost 3% a year between 1960 and 1973; since then it has languished at annual average growth of 1.1%. Chart 2 compares America's performance with that of other rich countries. Although productivity growth has slowed across the board since the early 1970s, America's growth rate is the lowest. What explains this?

Economists have not been short of suggestions. One is that these countries began the post-war period far behind America, and so have been catching up. A second is that investment - whether in physical capital or in skills - tends to increase labour productivity, by making workers more efficient; and Europe and Japan invest more heavily than America. The first explanation suggests that there is nothing America can do about its weak relative performance; the second suggests that policy changes might improve it.

A third possibility is that America's relative performance is not bad at all. Instead, it may be due to faulty measurement. For example, in manufacturing, where output (whether of widgets or wheelbarrows) is relatively easy to gauge, America's productivity performance is impressive. Yet this sector accounts for only 17% of America's GDP - a lower share than in other rich countries. Much of the rest of the American economy is devoted to services, where output - and hence productivity - is trickier to measure. If a bigger share of output comes from a sector in which production is underestimated, a country's productivity growth rate may look artificially low.

Myth or measurement?

In a recent paper* Robert Gordon, an economist at Northwestern University, argues that no single factor can explain America's reported productivity slowdown. Take the measurement problem. Mr Gordon makes a strong case that, especially in America, output measures fail to capture productivity gains. The consumer price index (CPI) is a particular difficulty. By failing to take into account quality improvements, or the possibility that goods can be purchased more cheaply from, say, discount stores, the official CPI overstates price rises. This results in artificially low estimates of output growth, and hence of productivity increases.

But this, he argues, is not the end of the story. Mr Gordon also finds that overall productivity figures hide widely different performance within separate industries. In the construction and utility sectors, for example, America has fared much worse than other rich countries. But the productivity of its railway and telecommunications industries compares well with the international competition. In traditional services (the health sector, retailing and so forth) America does particularly badly. What is going on?

In the service sector, Mr Gordon reckons that much of America's poor performance stems from the structure of its labour market. Weak unions and low minimum wages have allowed real wages at the bottom to fall. This, in turn, means that American companies hire relatively more (cheaper) workers than their European counterparts. Hence the average American restaurant has more waiters and table-clearers than its European equivalent; the average supermarket has more attendants at the check-out. Slow overall growth in productivity in these American sectors is, in part, the mirror-image of high unemployment in Europe.

By focusing on the disparities in productivity performance across sectors, Mr Gordon highlights a crucial point: that it makes no sense to look for one general explanation of declining productivity growth. The shift to services, with its measurement problems, may explain much. But so may the fact that America has a more efficient labour market, that it saves less than other economies, and that, as a technology leader, it is likely to improve less fast than countries catching it up.

Questions of relative performance aside, all rich-country governments should consider ways in which they can boost productivity. Policies to increase investment, whether by encouraging domestic savings or promoting investment in skills, seem obvious candidates. Unfortunately, the number of good policies per politician is growing at an anaemic rate. Time to get to work.

* 'Problems in the Measurement and Performance of Service-Sector Productivity in the United States'. NBER Working Paper No. 5519. March 1996.